

**STATE OF NORTH DAKOTA  
BISMARCK, NORTH DAKOTA**

**REPORT OF EXAMINATION  
OF  
HOMESITE INSURANCE COMPANY  
OF THE MIDWEST  
MANDAN, NORTH DAKOTA**

**AS OF  
DECEMBER 31, 2000**

STATE OF NORTH DAKOTA  
DEPARTMENT OF INSURANCE

I, the undersigned, Commissioner of Insurance of the State of North Dakota do hereby certify that I have compared the annexed copy of the Report of Examination of the

**Homesite Insurance Company of the Midwest**

**Mandan, North Dakota**

as of December 31, 2000, with the original on file in this Department and that the same is a correct transcript therefrom and of the whole of said original.

IN WITNESS WHEREOF, I have hereunto  
set my hand and affixed my official  
seal at my office in the City of  
Bismarck, this \_\_\_\_\_ day of  
\_\_\_\_\_, 2001.

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Jim Poolman  
Commissioner of Insurance

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Boston, Massachusetts  
October 15, 2001

Honorable Alfred W. Gross  
Chair, Financial Condition Committee  
Subcommittee, NAIC  
Commissioner  
Bureau of Insurance  
Commonwealth of Virginia  
Richmond, VA 23218

Nathaniel S. Shapo  
Chair, Midwestern Zone  
Director  
Illinois Department of Insurance  
320 West Washington Street, 4<sup>th</sup> Floor  
Springfield, IL 62767

Honorable Jim Poolman  
Commissioner of Insurance  
State of North Dakota  
600 East Boulevard  
Bismarck, ND 58505

Commissioners:

Pursuant to your instructions and statutory requirements, a financial examination has been made of the books, records, and financial condition of

**Homesite Insurance Company of the Midwest**

**Mandan, North Dakota**

hereinafter referred to as the "Company." The examination was conducted at the Company's main administrative office located at 99 Bedford Street, Boston, Massachusetts. The Company was last examined as of December 31, 1995. The report of examination is herewith respectfully submitted.

**SCOPE OF EXAMINATION**

This examination was a financial condition examination conducted in accordance with N.D. Cent. Code § 26.1-03-19.3 and observed guidelines and procedures contained in the National Association of Insurance Commissioners (NAIC) Examiners Handbook. The examination was conducted to determine the Company's financial condition, its compliance with statutes, and to review the corporate affairs and insurance operations. This statutory examination covers the five-year period beginning January 1, 1996, and ending December 31, 2000, and includes a review and analysis of the Company's operations, verification of assets, and valuation of

liabilities as of December 31, 2000. Any material transactions and/or events occurring subsequent to the examination date have also been considered where relevant to the Company's current condition.

Work papers provided by the Company's independent auditor, PricewaterhouseCoopers L.L.P., were reviewed and where deemed appropriate certain procedures and conclusions documented in those work papers have been relied upon and copied for inclusion into the working papers for this examination.

The findings of the prior report of examination were not considered relevant to this report due to the change in corporate ownership.

This examination was conducted by an Examiner from the North Dakota Insurance Department, representing the Midwestern Zone.

## **HISTORY**

### **General**

The Company was incorporated October 9, 1969, as Dawson Hail Insurance Company. The Company was licensed to write multiple-line property and casualty insurance. On July 14, 1995, Crop Growers Corporation, an indirect subsidiary of Fireman's Fund Insurance Company, acquired all of the outstanding common stock. On May 5, 1999, Crop Growers Corporation sold the common stock of Dawson Hail Insurance Company to Homesite Group Incorporated (formerly Homeowners Direct Corporation), a Delaware corporation. Simultaneously, the current title was adopted.

Prior to finalization of the sale, the Department approved a Reinsurance and Liabilities Assumption Agreement between the Company and Fireman's Fund Insurance Company under which the Company ceded all of its liabilities and obligations to Fireman's Fund Insurance Company.

### **Capital Stock**

The Company's Articles of Incorporation authorize the Company to issue 15,000 shares of common capital stock with a par value of \$215 per share. At December 31, 2000, the Company had issued 14,000 shares to its parent, Homesite Securities Company L.L.C.

### **Dividends to Stockholders**

The Company declared and paid the following cash dividends to stockholders during the period under review:

1996	\$2,500,000
1999	\$3,044,763 (extraordinary dividend)

The Department approved the 1999 extraordinary dividend payment as required by N.D. Cent. Code § 26.1-10-05.

## **MANAGEMENT AND CONTROL**

### **Stockholders**

The Company's Bylaws establish the date of the annual meeting of stockholders on or before the second Thursday in April or at such other time as determined by the Board of Directors.

The following chart depicts the holding company system as of December 31, 2000:

	<b><u>Domicile</u></b>
Homesite Group Incorporated	Delaware
Homesite Indemnity Company	Kansas
Homesite Securities Company LLC	Delaware
Homesite Insurance Company	Connecticut
Homesite Insurance Company of California	California
Homesite Insurance Company of the Midwest	North Dakota
Homesite Insurance Agency, Inc.	Pennsylvania
Homesite Insurance Company of Pennsylvania	Pennsylvania
Homesite Insurance Company of New York	New York
Homesite Insurance Company of Illinois	Illinois
Texas-South of Homesite, Inc.	Texas

According to the March 1, 2001 holding company statement, the following persons held or owned 10 percent or more of any class of voting security of Homesite Group Incorporated:

- The Plymouth Rock Company Incorporated held 17,732 common shares and 4,823 preferred shares constituting 11.6% of the total of all shares.
- Morgan Stanley Capital Partners III, L.P. held 88,465 preferred shares constituting 45.6% of the total of all shares.
- HDC Investors, L.P. held 57,336 shares constituting 29.6% of the total of all shares.

### **Board of Directors**

The Bylaws specify that the business and affairs of the Company shall be managed by a Board of Directors consisting of not less than one nor more than nine directors. Each director shall hold office until the next annual shareholder meeting or until a successor is elected and qualified. Annual meetings of the Board of Directors shall be held immediately following the annual shareholders' meetings. Regular meetings of the Board may be held at such times and places within or without the State of North Dakota as the Directors shall determine.

The directors serving as of December 31, 2000, are as follows:

<u>Name and Residence</u>	<u>Principal Business Affiliation</u>
Randall E. Dyen Foxboro, MA	General Counsel Homesite Group, Inc.
Manuel Z. Rios Duxbury, MA	Vice President/Underwriting Homesite Group, Inc.
James T. Morahan, Jr. Foxboro, MA	Finance Manager Homesite Group, Inc.
Fabian J. Fondriest Concord, MA	Executive Vice President Homesite Group, Inc.
Charles L. Kline Chestnut Hill, MA	President Homesite Group, Inc.
Anthony Scavongelli Duxbury, MA	General Counsel Homesite Insurance Companies

### **Officers**

Principal officers serving at December 31, 2000, are as follows:

Fabian J. Fondriest	President
Randall E. Dyen	Secretary and Vice President
James T. Morahan, Jr.	Treasurer
Sead Jahic	Vice President
Manuel Z. Rios	Vice President
Bennett C. Verniero	Vice President

### **Committees**

The Bylaws provide that the Board of Directors may create one or more committees and appoint members of the Board to serve on them. Each committee must have two or more members, who serve at the pleasure of the Board of Directors.

There were no committees created by the Board during the period under examination.

### **Conflict of Interest**

The officers and Directors completed a conflict of interest questionnaire for 2000. The conflicts of interest disclosed did not appear to represent significant conditions and the Examiner did not note any other conflicts of interest during the examination.

## **Stockholders and Board of Directors Minutes**

The minutes of the meetings of the stockholders and Board of Directors were reviewed for compliance with the Articles of Incorporation, Bylaws, and statutory requirements.

The Examiner noted that the 1999 investment transactions were not approved by the Board of Directors. The Board of Directors approved all investment transactions for year 2000 at its December 6, 2000, meeting. The Company has entered into an agreement with an investment advisor to manage its security portfolio within stated parameters. That arrangement, by itself, does not meet the provisions of N.D. Cent. Code § 26.1-05-18 which requires the purchase of an investment to be authorized by the Board of Directors or by an Investment Committee appointed by the Board.

**It is recommended that the Board of Directors document, on at least a quarterly basis, its review and approval of investment advisor transactions.**

The Articles of Incorporation were amended and restated at the September 29, 1999, meeting of the stockholders.

Article IV of the Articles of Incorporation was amended at the November 16, 1999, meeting of the stockholders. The amendment increased the par value of the Company's common capital stock from \$180 to \$215 per share, established one class of stock denominated common stock, and canceled the previously issued 800 Class "A" common shares and 14,200 Class "B" common shares with a par value of \$180 per share.

## **FIDELITY BOND AND OTHER INSURANCE**

The Company is a named insured on a financial institution bond issued to its ultimate parent, Homesite Group Incorporated. Other affiliated and non-insurance companies are also named insureds on the bond which provides coverage in the amount of \$2,000,000. The coverage meets the minimum amount of fidelity bond coverage recommended by the National Association of Insurance Commissioners for the Company and the insurance subsidiaries. Other insurance coverage covering the Company appeared adequate.

## **INTERCOMPANY AGREEMENTS**

### **Intercompany Service Agreement**

Effective July 26, 1999, the Company entered into a service agreement with its ultimate parent, Homesite Group Incorporated (HGI). A summary of the agreement follows:

- HGI shall lease employees to the Company that the management of the Company determine, in their sole discretion, are qualified to perform insurance services and shall be obligated to provide the facilities and resources the Company shall require.
- HGI shall not exercise judgment in rendering employee and facilities leasing services to the Company. The Company shall have complete control over such employees and services. The management of the Company shall have complete



and absolute control of and responsibility for its business and operations and shall direct, supervise, and control the day-to-day activities of the leased employees.

- The Company shall reimburse HGI for actual salary and support expenses, to the extent the Company considers such expenses to be reasonable and customary. HGI shall provide a monthly statement of expenses.

The Company incurred expenses of \$443,000 and \$147,000 for services provided by HGI for the years 2000 and 1999, respectively.

### **Consolidated Federal Income Tax Allocation Agreement**

The Company and the other entities of the Homesite Group Incorporated holding company system entered into federal income tax allocation agreement dated February 28, 2000, for the allocation of liability due to the consolidated federal income tax return of the Homesite Group Incorporated group of companies.

The agreement provides that within 30 days after payment by HGI, each member shall reimburse HGI for the amount of federal income taxes that the HGI has paid on each member's behalf. The amount payable by any member in any taxable year shall not exceed the tax liability in such year which would have been payable by the member if it had filed a separate return.

## **PENSION, STOCK OWNERSHIP, AND OTHER INSURANCE PLANS**

Homesite Group Incorporated (HGI) provides eligible employees with a health care insurance package consisting of medical, dental and vision benefits, short-term and long-term disability, basic term life insurance, and accidental death and disability insurance.

HGI has a 401(k) savings program to assist all eligible employees in providing for retirement and other financial needs. Employees may contribute up to 15 percent of their salary to the 401(k) plan on a pre-tax tax deferred basis. HGI will match \$.50 for each \$1.00 of employee contributions, up to 5% of their annual compensation. HGI may also make a discretionary contribution at the end of each plan year.

## **TERRITORY AND PLAN OF OPERATION**

At December 31, 2000, the Company was licensed in the following states:

Georgia	Indiana	Iowa	Kansas
Maryland	Michigan	Minnesota	Montana
North Dakota	Ohio	Oregon	South Carolina
South Dakota	Tennessee	Washington	West Virginia

The Company was also licensed to transact business in the District of Columbia.

The Company markets homeowner's insurance and related coverages on a direct basis. Prospective customers responding to marketing efforts contact the Company via toll-free telephone numbers, the Internet, or by facsimile. The Company currently has a call center in White Plains, New York and one in Boston, Massachusetts.

The Company is a member of the Insurance Services Office, Inc. (ISO) for the homeowner's, personal liability, and personal inland marine lines. Policies offered use ISO standard forms and endorsements. Company-specific coverage offerings and endorsements to serve targeted market segments are available.

## **STATUTORY DEPOSITS**

The Company maintained the following deposits at December 31, 2000:

<b>Location</b>	<b>Type of Asset</b>	<b>Statement Value</b>	<b>Market Value</b>
Georgia	Bond	\$ 34,673	\$ 36,050
South Carolina	Bond	128,784	133,900
Tennessee	Bond	203,083	211,150
North Dakota	Bond	693,453	721,000

The statement value of securities held in a custodial account and vested in the Commissioner of Insurance of the State of North Dakota for the benefit of all policyholders totaled \$693,453.

## **REINSURANCE**

### **Reinsurance Ceded**

The following is a schedule of the principal reinsurance ceded treaties in force at December 31, 2000:

1.    Type:                   Excess of Loss
 

Reinsurers:           General Reinsurance Corporation – 50%  
                               American Re-Insurance Company – 50%

Scope:                 Homeowners

Coverage:            The first four layers cover homeowners property business and the fifth layer covers liability business.

1<sup>st</sup> Layer: \$150,000 excess of \$100,000 not to exceed \$750,000 one occurrence.

2<sup>nd</sup> Layer: \$250,000 excess of \$250,000 not to exceed \$1,000,000 one occurrence.

3<sup>rd</sup> Layer: \$500,000 excess of \$500,000 not to exceed \$1,500,000 one occurrence.

4<sup>th</sup> Layer: \$1,000,000 excess of \$1,000,000 not to exceed \$3,000,000 one occurrence.

5<sup>th</sup> Layer: \$1,900,000 excess of \$100,000.

Premium: Scheduled

Commissions: None

Effective Date: June 14, 1999

Termination: Either party upon 90 days written notice

2. Type: Quota Share

Reinsurers: AXA Reassurance S.A.

Scope: Homeowners business produced by General Motors Acceptance Corporation or its affiliates.

Coverage: 90% of net liability

Premium: 90%

Commissions: 25% provisional commission. The first adjustment period covers the period from effective date through March 31, 2003. The minimum and maximum commission is 25% and 35%, respectively.

Effective Date: April 1, 2000

Termination: By reinsurer three years after any March 31 or by the Company at any March 31. Either party must give 90 days written notice.

All treaties contained an insolvency clause required by N.D. Cent. Code § 26.1-02-21.

## **ACCOUNTS AND RECORDS**

The Company uses Freedom software for general ledger and accounts payable processing. Policies are processed on the Horison software system and claims on Vantive software.

A trial balance was extracted from the general ledger for the year ended December 31, 2000, and reconciled to the appropriate exhibits and schedules in the Company's annual statement.

The Company is audited annually by an outside firm of independent certified public accountants. The workpapers of this firm were made available to the Examiners and were used to the extent deemed appropriate for this examination.

## **FINANCIAL STATEMENTS**

The following pages present a Statement of Assets, Liabilities and Surplus as of December 31, 2000. This statement is followed by supporting statements and reconciliations presented in the following order:

Statement of Assets, Liabilities and Surplus, December 31, 2000

Summary of Operations for the Year Ending December 31, 2000

Reconciliation of Capital and Surplus, January 1, 1996, through December 31, 2000

**Homesite Insurance Company of the Midwest**  
**Statement of Assets, Liabilities, and Surplus**  
**December 31, 2000**

<b><u>Assets</u></b>	<b><u>Total Assets</u></b>	<b><u>Assets Not Admitted</u></b>	<b><u>Admitted Assets</u></b>
Bonds	\$1,059,992		\$1,059,992
Cash on deposit	14,765		14,765
Short-term investments	6,757,262		6,757,262
Premiums in the course of collection	(1,667)		(1,667)
Interest due and accrued	<u>15,833</u>		<u>15,833</u>
Total Assets	<u><u>\$7,846,185</u></u>		<u><u>\$7,846,185</u></u>
<b><u>Liabilities and Surplus</u></b>			
Losses			\$ 6,768
Loss adjustment expenses			337
Other expenses			25,284
Federal income taxes			1,764
Unearned premiums			23,575
Payable to parent, subsidiaries and affiliates			<u>120,876</u>
Total Liabilities			\$ 178,604
Common capital stock			3,010,000
Gross paid in and contributed surplus			1,441,916
Unassigned funds			<u>3,215,665</u>
Surplus as Regards Policyholders			\$7,667,581
Total Liabilities and Surplus			<u><u>\$7,846,185</u></u>

**Homesite Insurance Company of the Midwest  
Summary of Operations  
For the Year Ending December 31, 2000**

**Underwriting Income**

Premiums earned		\$ 13,960
Less:		
Losses incurred	\$ 9,625	
Loss expenses incurred	337	
Other underwriting expenses incurred	<u>471,428</u>	
Total underwriting deductions	<u>\$ 481,390</u>	
Net underwriting gain		(467,430)

**Investment Income**

Net investment income earned	\$ 394,509	
Net realized capital gain (loss)	<u>93,734</u>	
Net investment gain		488,243

**Other income**

Finance and service charges		<u>1,323</u>
Net income before federal taxes		\$ 22,137
Federal income tax incurred		<u>2,490</u>
Net income (loss)		<u><u>\$ 19,647</u></u>

**Homesite Insurance Company of the Midwest  
Reconciliation of Capital and Surplus Account  
January 1, 1996, through December 31, 2000**

	<b>2000</b>	<b>1999</b>	<b>1998</b>	<b>1997</b>	<b>1996</b>
Capital and Surplus December 31, Previous Year	\$7,641,925	\$8,706,728	\$8,378,853	\$8,806,867	\$8,204,035
Net Income	19,647	200,970	379,875	(476,014)	1,053,259
Change in Non-admitted Assets	6,010	(6,010)			
Change in Provision for Reinsurance				48,000	(48,000)
Change in Excess of Statutory Reserves Over Statement Reserves		100,000	(100,000)		
Paid in Capital		490,000			
Paid in Surplus		1,195,000			
Transferred From Surplus					1,120,000
Transferred to Capital					(1,120,000)
Dividends to Stockholders		(3,044,763)			(2,500,000)
Corporate Adjustment			48,000		
Correction of Prior Period Error					2,097,573
Net Change in Capital and Surplus for the Year	<u>\$ 25,657</u>	<u>\$(1,064,803)</u>	<u>\$ 327,875</u>	<u>\$ (428,014)</u>	<u>\$ 602,832</u>
Capital and Surplus December 31, Current Year	<u>\$7,667,581</u>	<u>\$7,641,925</u>	<u>\$8,706,728</u>	<u>\$8,378,853</u>	<u>\$8,806,867</u>

## CONCLUSION

The financial condition of the Company, as of December 31, 2000, as determined by this examination is summarized as follows:

ADMITTED ASSETS		<u>\$7,846,185</u>
Total Liabilities		\$ 178,604
Common Capital Stock	\$3,010,000	
Gross Paid In and Contributed Surplus	1,441,916	
Unassigned Funds	<u>3,215,665</u>	
Surplus as Regards Policyholders		<u>7,667,581</u>
LIABILITIES, SURPLUS AND OTHER FUNDS		<u>\$7,846,185</u>

The courtesy, assistance, and cooperation extended by the Company during the examination is hereby acknowledged and appreciated.

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David Weiss, CFE  
Examiner-in-Charge  
North Dakota Insurance Department



## **COMMENTS AND RECOMMENDATIONS**

It is recommended that the Board of Directors document, on at least a quarterly basis, its review and approval of investment advisor transactions.